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ST. CLOUD AREA QUARTERLY BUSINESS REPORT

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SLOW, UNEVEN GROWTH PERSISTS

EXECUTIVE SUMMARY

Area economic performance continued to be weak and uneven in the past three months as employment declined in manufacturing and retail trade sectors.

While manufacturing and retail account for almost 30 percent of area employment, job gains in key sectors such as professional and business services, financial activities, education and health were sufficient to deliver year-over-year employment growth of 1.4 percent in April 2008. Although many local companies continue to face challenging market conditions, the area economy appears to have narrowly averted a recession at this time.

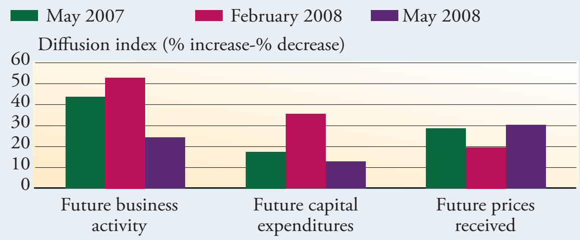
The St. Cloud economy is a bright spot compared with the Twin Cities. Job growth in the Minneapolis-St. Paul metro area was a meager 0.7 percent in the year ending April 2008, with pronounced declines in construction and manufacturing. St. Cloud-area construction employment grew at a 1.6 percent year-over-year rate, while the same sector was declining by 3.9 percent in the Twin Cities and 5.3 percent in the state as a whole. While weakness in the area housing sector continues, an abundance of local commercial construction projects has been important in maintaining construction employment.

The St. Cloud Index of Leading Economic Indicators fell sharply, decreasing 3.44 percent from January to April. The decline was almost entirely due to a decrease in help-wanted advertising. The probability of recession indicator puts the likelihood of recession by late summer at 58.8 percent. Current data for area employment does not indicate the start of a recession yet, however.

Forty percent of surveyed firms report an increase in economic activity in the past three months, while 28 percent report a decrease. Surveyed current employment conditions remain weak, with only 15 percent of the 86 firms that returned this quarter's St. Cloud Area Business Outlook Survey reporting increased hiring in the past three months and 21 percent trimming employment. Employee compensation numbers were the second-lowest recorded in the current business conditions survey, while surveyed capital expenditures and national business activity items remained weak.

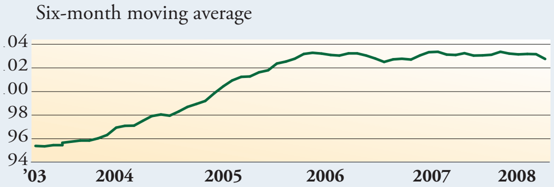
The future outlook is not as bright as it was three months ago when 60 percent of surveyed firms expected an increase in activity in six months. This quarter, only 41 percent of surveyed firms expect improved conditions in the next six months, and 16 percent expect conditions to worsen in the same period. While this is, at least in part, a normal seasonal pattern, it should be noted that this is among the worst spring readings recorded. Indeed, the outlook for future employment, hours worked and capital expenditures is very weak relative to what is usually

KEY RESULTS OF SURVEY



INDEX OF LEADING ECONOMIC INDICATORS

Six-month moving average



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observed in the spring survey. Combine this with concerns for future national business activity and the largest expected increase in prices received in two years, and one sees emerging an economy that is experiencing stagflationary pressures and is particularly vulnerable to an adverse shock.

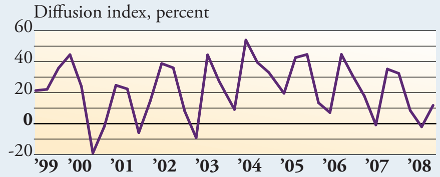
In special questions, one-third of surveyed firms expect the closing of the DeSoto Bridge to have an unfavorable effect on their company. Forty percent of firms report they plan to increase prices in the next six months in response to rising oil prices. Recent turmoil in credit markets appears to be having only a limited adverse impact on area firms.

CURRENT ACTIVITY

Tables 1 and 2 report the most recent results of the business outlook survey. Responses are from 86 area businesses that returned the recent mailing in time to be included in the report. Participating firms are representative of the diverse collection of businesses in the St. Cloud area. They include retail, manufacturing, construction, financial, health services and government enterprises ranging from small to large. Survey responses are strictly confidential. Written and oral comments have not been attributed to individual firms.

Survey responses suggest in the past three months the St. Cloud area continued to experience economic conditions that are weaker than normal for this time of year. The current activity diffusion index (representing the percentage of respondents indicating an increase minus the percentage indicating a decrease in any given quarter) is 11.6 in this quarter's survey, which is much lower than was reported one year ago (when it was 35.0), but is above the reading of -2.3 three months ago.

CURRENT BUSINESS ACTIVITY



The employment diffusion index recorded its first negative reading in several years in the spring survey. This marks the third straight quarter in which area firms reported more employees were removed from payrolls than added. While firms appear to be reluctant to hire new workers, they do appear to be putting their existing workers to more use. The length of workweek survey item turned positive for the first time in three quarters as 19 percent of firms reported a longer workweek and 13 percent reported a decrease in the length of the workweek. This is quite consistent with what might be expected during such an uncertain phase of economic activity. With substantial startup costs associated with a new hire, it makes sense for a firm to respond to increased demand by more intensively using the existing capacity of its human and capital resources. Worker shortages appear to continue to be of little concern to area firms. Capital expenditures, while rebounding slightly from a low reading last quarter, remain historically weak. The prices received index was unchanged from last quarter, and the national business outlook improved only slightly from last quarter's -18.4 value. This is the first time since 2001 (when the national and area economies were in recession) that three consecutive negative readings have been recorded for the national business activity index.

One area of continuing interest is the current diffusion index on employee compensation. With a value of 14, this index is the second-lowest recorded in the almost 10 years the survey has been conducted. The only other time this index was this low was in the December 2001 survey, when

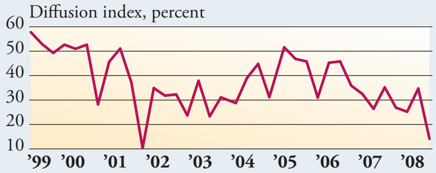
TABLE 1-CURRENT BUSINESS CONDITIONS

	May 2008 vs. Three months ago				February 2008
	Decrease (%)	No Change (%)	Increase (%)	Diffusion Index[3]	Diffusion Index[3]
What is your evaluation of:					
Level of business activity for your company	27.9	32.6	39.5	11.6	-2.3
Number of employees on your company's payroll	20.9	64.0	15.1	-5.8	-4.6
Length of the workweek for your employees	12.8	68.6	18.6	5.8	-10.4
Capital expenditures (equipment, machinery, structures, etc.) by your company	11.6	66.3	20.9	9.3	3.4
Employee compensation (wages and benefits) by your company	11.7	72.1	25.6	13.9	34.5
Prices received for your company's products	16.3	54.7	26.7	10.4	10.4
National business activity	29.1	46.5	14.0	-15.1	-18.4
Your company's difficulty attracting qualified workers	9.3	74.4	16.3	7.0	9.2

Notes: (1) Reported numbers are percentages of businesses surveyed. (2) Rows may not sum to 100 because of "not applicable" and omitted responses. (3) Diffusion indexes represent the percentage of respondents indicating an increase minus the percentage indicating a decrease. A positive diffusion index is generally consistent with economic expansion.

Source: SCSU Center for Economic Education, Social Science Research Institute and Department of Economics the U.S. economy was deeply mired in economic uncertainty. On the one hand, firm cutbacks on wages and salaries are a natural adjustment to nonlabor cost pressures (such as rising energy prices and imported materials costs). However, this has an obvious indirect effect on area businesses, and workers are not likely to accept declining real earnings for a sustained period. Indeed, we suspect the Federal Reserve will soon shift its focus from recessionary/financial stability concerns to concentration on preventing or containing stagflationary pressures that could eventuate from a potential wage-price spiral.

CURRENT EMPLOYEE COMPENSATION



WHAT IS AFFECTING YOUR COMPANY?

Comments to this question include:

• We are (a residential and commercial construction firm that is) also impacted by the rising metal market.

• Sluggish economy is hindering any growth. We are promoting other services ... to keep in front of prospects and clients.

• As a seasonal business, the longer-than-normal winter is exacerbating the residential building slowdown.

• Spending decisions reflect more caution.

• Recent increases in diesel fuel prices have (had an adverse effect on our business).

• Freight costs for shipping our products affect the total price to customers. This hurts our competitive position and can lower profits.

• Rising oil prices have increased the demand for fuel efficient models, but slowed down truck and SUV business.

• No idea for next six months — fuel prices, raising taxes, home market. We're planning to keep all expenditures to a bare minimum.

• We are cautiously optimistic about the upcoming construction season. Although we have bid projects at abnormally low profit margins, we have more work on the books than we've had for the past five years.

• Our misguided biofuels policy will create substantial food inflation and only a 1 percent reduction in oil imports.

• Postage increases are adversely affecting us.

• Fuel economics and media negativity (are affecting our business).

• We need cities to take action and move some projects forward — the bidding climate is very good.

• Our high business cycle ended in April.

• Part of what we do is to repair or replace broken parts. Times get hard, people fix instead of new, we get a large bump in sales.

FUTURE OUTLOOK

After one quarter in which the future outlook appeared to be brightening, this quarter's diffusion index on expected future business activity is surprisingly weak. Compared with last spring (when the index was 43.7) and May 2006 and 2005 readings of 43.3 and 56.5, respectively, this quarter's 24.4 index is well below that which is normally observed. It remains to be seen whether this translates into a persistence of the observed slow growth trends through November 2008 or is somehow associated with an actual reduction in overall area economic activity. But this is an unmistakably weak signal of future activity.

The future employment diffusion index

TABLE 2-FUTURE BUSINESS CONDITIONS

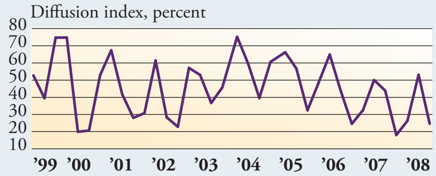
	Six months from now vs. May 2008				February 2008
	Decrease (%)	No Change (%)	Increase (%)	Diffusion Index[3]	Diffusion Index[3]
What is your evaluation of:					
Level of business activity for your company	16.3	37.2	40.7	24.4	52.9
Number of employees on your company's payroll	14.0	59.3	20.9	6.9	23.0
Length of the workweek for your employees	11.6	69.8	12.8	1.2	19.6
Capital expenditures (equipment, machinery, structures, etc.) by your company	8.1	65.1	20.9	12.8	35.6
Employee compensation (wages and benefits) by your company	1.2	57.0	34.9	33.7	34.5
Prices received for your company's products	8.1	44.2	38.4	30.3	19.6
National business activity	12.8	53.5	18.6	5.8	5.7
Your company's difficulty attracting qualified workers	7.0	67.4	19.8	12.8	13.8

Notes: (1) Reported numbers are percentages of businesses surveyed. (2) Rows may not sum to 100 because of "not applicable" and omitted responses. (3) Diffusion indexes represent the percentage of respondents indicating an increase minus the percentage indicating a decrease. A positive diffusion index is generally consistent with economic expansion.

Source: SCSU Center for Economic Education, Social Science Research Institute and Department of Economics

FUTURE BUSINESS ACTIVITY

Diffusion index, percent

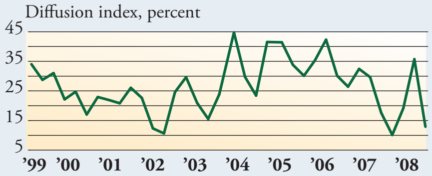


is similarly weak (18 points lower than recorded one year ago). The length of the workweek and labor shortage indexes are also low. This translates into sluggish growth at best and a poor outlook for current and prospective area workers. The diffusion index on expected future employee compensation is the lowest recorded and is a continuation of a downward trend that was highlighted in last quarter's St. Cloud Area Quarterly Business Report.

Expected future capital expenditures took a precipitous drop from last quarter's encouraging index value. At a value of 12.8, this is the lowest spring number recorded since 2002 and is much weaker than normally observed. This series has relatively little predictable seasonal variability, so the reversal of last quarter's 35.6 index on this item does not bode well for the area economic outlook. As is well known, area firms cut back on planned capital purchases during times of heightened economic uncertainty. This item will be closely watched in next quarter's survey.

FUTURE CAPITAL EXPENDITURES

Diffusion index, percent



Finally, it must be noted that the future outlook for national business activity is little changed from last quarter. This is somewhat of a surprise, because economic stimulus from both expansionary monetary and fiscal policy is likely to have a short-run impact on the path of economic activity over the next few months.

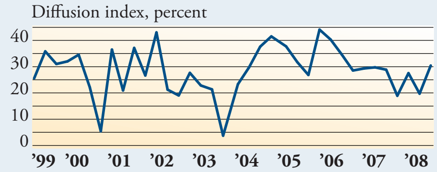
Many observers question the overall efficacy of the tax rebate program. The aggressive monetary policy actions of recent months could, when combined with rising oil prices, help fuel a surge in observed and expected inflation. All of this could lead to a variety of unfavorable economic outcomes by the end of 2008.

All eyes will be on the Federal Reserve in coming months as it tries to navigate its way through the most challenging economic and financial conditions since the 1970s. One of the challenges Federal Reserve Chairman Ben Bernanke and his colleagues will face is the potential of an accelerating overall level of prices. The accompanying chart illustrates that this quarter's outlook on expected future prices received is markedly different from that of last quarter. Given all that we have seen elsewhere in this quarter's survey (also see special question 2 below), it seems very unlikely this increase in the future prices received index is attributable to expanded profit margins. Therefore, it is quite likely that prices received in the future will be responsive to increased production costs.

It should be noted that designing a policy course in response to aggregate cost-driven price pressures is among the most challenging concerns that is faced by a central bank. So, stay tuned. The next few months should prove very interesting as independent Federal Reserve policymakers are forced to make tough and unpopular decisions during what is certain to be a contentious national presidential campaign.

FUTURE PRICES RECEIVED

Diffusion index, percent

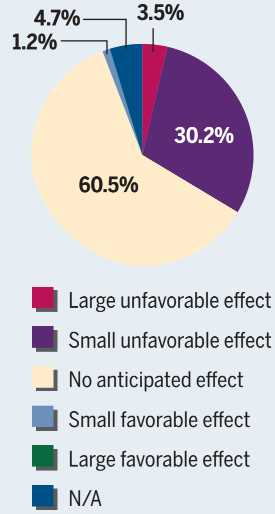


SPECIAL QUESTIONS

Virtually everyone traveling to and through St. Cloud has been affected by the recent closing of the DeSoto Bridge on Minnesota Highway 23. The bridge-replacement project is expected to occur in various phases in the next 18 months. We were interested in asking survey respondents to report on the extent to which the closing of this downtown bridge was expected to impact their business in the next year and a half.

QUESTION 1

To what extent do you expect the closing of the DeSoto Bridge on Highway 23 in St. Cloud to (either directly or indirectly) impact your business over the next 18 months?



*Numbers may not add up to 100 due to rounding.

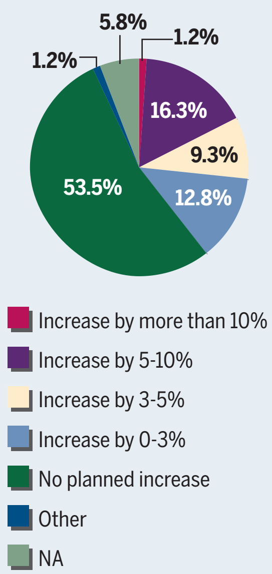
One-third of surveyed firms expect the bridge closing to unfavorably affect their firm (although 30 percent think the unfavorable effect will be small and only three firms expect a large negative impact). Sixty percent of surveyed firms expect "no anticipated effect." Only one firm expects it will have a (small) favorable impact. It appears that any adverse effects of the bridge closing are likely to be localized and, while creating some inconveniences, won't have a major impact on the overall area economy.

Responses to Special Question 1:

- "Bridge closing has hurt (our) downtown location — people avoiding downtown — finding alternative routes."
- "It is unfortunate that the I-35 bridge failure caused the powers to be to close the DeSoto Bridge entirely rather than limiting to one lane in each direction."
- "It should not affect our revenues, but it will take longer to get to our customers east of the river. I'm glad our business is on the west side of town."
- "We just drive around to other bridges — small hassle."

In recent weeks, oil futures prices have, at times, topped $130 per barrel, and gas prices are hovering at about $4 per gallon. It has been 30 years since we have experienced this type of abrupt increase in the price of such a key productive input. Historically, a supply shock of the form that we are experiencing has been — when combined with an accommodating monetary policy course — associated with stagflationary pressures (that is, economic stagnation and accelerating inflation). This is the worst possible shock that can be experienced by an economy that is accustomed to trying to counter swings in economic activity — stimulative policies that attempt to accommodate supply shocks are doomed to long-run failure. These policies might achieve short-run employment-related objectives, but only at a cost of accelerating inflation. One key to keeping inflationary pressures contained is to try to keep higher oil price increases from creating a general price increase. In the long run, allowing an economy to adjust to an increase in the relative price of oil is necessary for achieving productive potential. With this in mind, we were interested in the extent to which area firms are planning price increases in response to rising oil prices.

QUESTION 2
To what extent does your business plan to increase prices over the next six months in response to rising oil prices?



*Numbers may not add up to 100 due to rounding.

About 60 percent of firms reported that they planned no increases (or indicated "other" or "not applicable"). Of the 40 percent of the firms that planned price increases, about 16 percent expected to increase their prices in the range of 5-10 percent. Nine percent of firms plan to increase prices by 3-5 percent, and 13 percent plan to increase prices by 0-3 percent.

Responses to Question 2:

• "Feed cost increases are more significant than energy increases."

• "We provide services — not a product. However, the designs and projects we work on have increased in cost due to national increases."

• "We don't determine the price of (the product we sell), but we have seen them increasing due to fuel prices."

• "We will have moderate increases based on demand for fuel efficiency."

• "5-10 percent increase in freight charges."

• "The only increase we plan to implement would be based on increases from our suppliers. Incoming freight is included in the individual piece prices on invoices we receive from suppliers."

• "We're not only seeing price increases because of oil, but also the rising cost of steel."

• "Increase in prices scheduled independent of oil prices."

• "We can't raise our prices based on rising oil prices."

• "All of our products are increasing — our fuel was $20,000 above last year and we expect that it will rise more than that this year."

• "Our (business) rates are set by the Legislature. … rates will increase slightly, but it is a routine annual increase that wasn't determined with oil prices in mind."

• "Unsure at this time; also impacted highly by housing crisis and it tempers rising prices even though gas prices are up."

• "Our clients would not be OK with such an increase."

• "Already increased."

This quarter's final special question related to the extent to which area firms are experiencing increased difficulties accessing credit in this challenging time of financial turbulence. The Federal Reserve's bold and unprecedented actions of recent months have gone a long way to reducing the instability of financial markets, but these moves have not been not been without their critics.

Time will tell whether the Fed made the right moves, but it appears there is less likelihood that a meltdown of key players on Wall Street will lead to a systemic economic crisis. With this in mind, and with continuing concern that weakness in housing and residential finance markets might contaminate other sectors of the local economy, we asked area firms to identify the extent to which their access to loans or other forms of credit has been affected by recent financial turmoil.

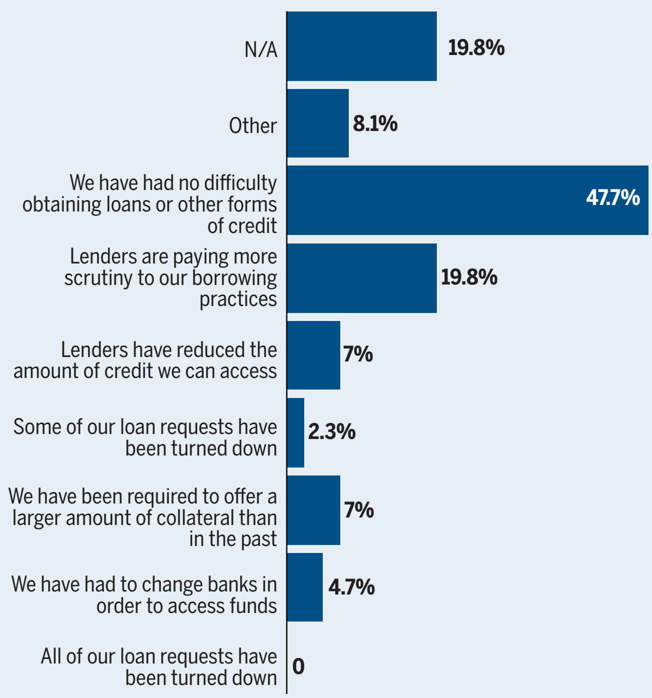
QUESTION 3
To what extent has recent turmoil in financial markets affected your business's access to loans (or other forms of credit) from banks or other financial services providers?

Note that we provided firms with a variety of options and asked them to "check all that apply," so the numbers do not total to 100%.

Almost half of surveyed firms noted "it has been business as usual — we have had no difficulty obtaining loans or other forms of credit." Eight percent answered "other" and 20 percent answered "NA." Firms in these two categories typically noted that they had not attempted to access credit or that they were themselves a lender (such as a bank). Of the remaining responses (about one quarter of firms reported issues related to access to credit), the most common response was:

"Lenders are paying more scrutiny to our borrowing practices." (20 percent of surveyed firms).

Seven percent of firms noted "lenders have reduced the amount of credit we can access" and "we have been required to offer a larger amount of collateral than in the past." Five percent of firms indicated "we have had to change banks in order to access funds" and a couple of firms noted that "some of our loan requests have been



turned down."

In all, this suggests local firms are not immune to the recent credit crunch, but, at least to date, most area firms' access to credit seems to have been unaffected by recent financial turmoil.

Responses to Special Question 3:

• "The housing market has seen major changes in financing. Buyers need more down payment (and) better credit scores to obtain financing today!"

• "Real estate — many mortgage vehicles have gone away — increased down payments and increased qualifications which has eliminated some buyers from the market."

• "It affects our customers with trying to obtain loans to expand, build, or remodel, therefore affecting the amount of work we get."

• "We have made changes due to some new terms and conditions being implemented."

• "Rates have not been as favorable as in the past."

• "Our working capital needs are increasing."

• "Personal guarantees are being requested, as well as loan approvals for our customers being rejected at a higher percentage."

• "A number of lenders no longer providing loans (to our customers)."

• "We've been fortunate to have reserves."

• "We haven't needed a loan, but clients (homebuyers) are finding it much harder to get financing."

A LOOK AT OTHER DATA

The St. Cloud economy has experienced a different labor market than the rest of the state, as evidenced by Table 3. The headline growth rate for employment of 1.4 percent for St. Cloud, versus 0.7 percent in the Twin Cities and in the state, is almost entirely accounted for by an increase in government employment here. Private-sector employment grew only 0.8 percent in St. Cloud, barely different from elsewhere in the state. Manufacturing employment fell 1.5 percent in the year through April in St. Cloud, compared with a 0.5 percent fall in the Twin Cities. The closure of Stearns Manufacturing announced in early May (and not reflected in the above figures) will drag on this sector through summer. Retail-sector employment fell 0.6 percent in this period.

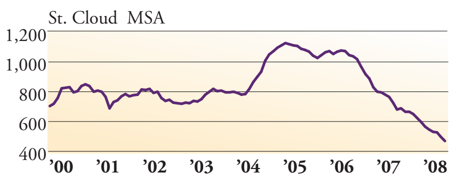
The stimulus checks from the federal tax rebate program may help end this trend.

WHEN WILL REAL ESTATE IMPROVE?

BEYOND MANUFACTURING AND THE RETAIL SECTOR, the construction and housing industry continues to be a drag on the local and national economies. We have noted on these pages in the past three years that there was an overbuilding of housing in 2004-05, when the construction industry added 400 houses annually. Without a large inflow of additional families into the St. Cloud area — which appears unlikely to materialize at this point — the previous level was probably close to equilibrium.

Thus one way to think about the overhang of housing is to look at the size of the bulge in building earlier this decade and wonder when the excess housing built will be sold off. This means the quantity of building should go down, and prices should fall. Housing inventory should rise at first, then fall. The data on building permits shows we have slowed well below the baseline level of building in St. Cloud.

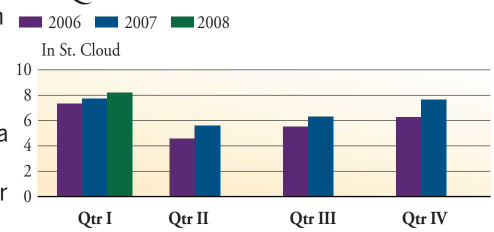
BUILDING PERMITS



Permits have fallen from the peak near 1,200 to below 500 per year in the 12 months to April. Construction employment has in fact stabilized, though with rotation from residential to commercial construction. Given that the rate of growth of families looking for housing has remained constant (Stearns County population growth has been steady at about 1.1 percent and Benton County has slowed to about the same rate, according to Census Bureau estimates), fewer building permits should lead to a reduction in the supply of new housing into the local market, which should help speed the correction in the housing market. Nevertheless, the stock of housing on the market relative to the sales reported by the St. Cloud Area Association of Realtors is still increasing.

The rise in inventories in the residential real estate market is proving to be a drag on home prices. According to the latest Realtors' report, the average sale price of homes in this market has fallen by 10 percent from the first quarter of 2007 to the first quarter of 2008. We cannot be sure we are comparing identical houses, and with the rise in foreclosures in the area there will be a depressing effect on prices. Rather than treating this as a problem, the market is going to need lower prices to help move the excess supply of homes more quickly. The market in St. Cloud appears finally to be moving toward dealing with the overhang.

RATIO OF LISTINGS TO QUARTERLY SALES



The question is how fast it will take for this to occur, and we cannot answer this question with certainty.

One effect of higher gas prices will be to slow the number of families who work in the Twin Cities and move to St. Cloud for cheaper housing. Highway miles traveled so far this year are below 2007 levels according to the Department of Energy, indicating commuters are carpooling, telecommuting or using alternative transportation. Also, the growth of young families has slowed, with the largest growing demographic in the area being families older than age 55 without children. This second effect is a longer-running trend that might slow the long-term rate of homebuilding in the area, and might shift that market to building homes that have fewer bedrooms and amenities that appeal to more mature buyers.

Lastly, while credit terms have tightened for borrowers, mortgage interest rates have held steady. The interest margin banks are earning on mortgages has widened in recent months, and if the cost of funds to banks stays at the current level through the end of the year (as Fed funds futures would suggest), credit may loosen and bring interest rates down from current levels.

None of these effects can be expected to improve real estate markedly this year, in our view. But better credit conditions and a slower flow of new homes into real estate inventories may help reduce one drag on the local economy.

TABLE 3 - EMPLOYMENT TRENDS

	St. Cloud (Stearns and Benton)			13-county Twin Cities area			Minnesota		
	15-year trend growth rate	April '07-April '08 growth rate	April '08 employment share	15-year trend growth rate	April '07-April '08 growth rate	April '08 employment share	15-year trend growth rate	April '07-April '08 growth rate	April '08 employment share
Total nonagricultural	2.0%	1.4%	100.0%	1.5%	0.7%	100.0%	1.4%	0.7%	100.0%
Total private	2.1%	0.8%	84.7%	1.6%	0.7%	86.3%	1.5%	0.7%	84.7%
Goods producing	1.7%	-0.9%	20.8%	0.2%	-1.8%	14.9%	0.4%	-1.7%	16.2%
Construction/natural resources	3.1%	1.6%	4.3%	2.8%	-5.3%	3.8%	2.5%	-3.9%	4.0%
Manufacturing	1.4%	-1.5%	16.5%	-0.5%	-0.5%	11.1%	-0.2%	-0.9%	12.2%
Service providing	2.0%	2.0%	79.2%	1.7%	1.2%	85.1%	1.6%	1.2%	83.8%
Trade/transportation/utilities	0.5%	0.8%	20.6%	1.0%	0.0%	18.7%	1.0%	0.4%	19.0%
Wholesale trade	1.7%	1.6%	4.4%	1.4%	0.2%	4.8%	1.4%	0.8%	4.8%
Retail trade	-0.2%	-0.6%	12.7%	1.1%	-0.3%	10.2%	1.0%	0.2%	10.8%
Trans./warehouse/utilities	2.2%	5.4%	3.5%	0.1%	0.5%	3.6%	0.5%	0.6%	3.4%
Information	1.6%	-2.7%	1.2%	0.7%	0.7%	2.4%	0.4%	-0.1%	2.1%
Financial activities	4.2%	2.7%	4.5%	1.6%	1.3%	7.9%	1.7%	1.2%	6.5%
Professional & business service	5.6%	5.3%	8.5%	2.1%	1.0%	14.8%	2.4%	1.3%	11.9%
Education & health	3.1%	1.2%	16.4%	3.4%	3.6%	14.5%	3.2%	3.1%	15.9%
Leisure & hospitality	2.7%	0.2%	8.9%	2.0%	0.6%	9.0%	1.8%	1.0%	8.8%
Other services (excluding govt.)	1.0%	-0.5%	3.7%	1.6%	0.7%	4.2%	1.1%	-0.7%	4.2%
Government	1.2%	4.5%	15.3%	1.1%	1.1%	13.7%	0.8%	0.7%	15.3%
Federal government	0.5%	2.9%	1.7%	0.1%	0.0%	1.2%	-0.2%	-0.4%	1.2%
State government	1.5%	4.9%	4.6%	1.7%	3.2%	4.2%	1.0%	1.3%	3.7%
Local government	1.2%	4.6%	9.1%	1.0%	0.2%	8.3%	0.8%	0.7%	10.5%

Note: Long-term trend growth rate is the compounded average employment growth rate in the specified period.

Source: Minnesota Department of Employment and Economic Development and author calculations.

Private-sector growth came in services, particularly the transportation sector and in professional and business services employment. Employment arising from goods production in the St. Cloud area continues to decline as a share of total employment, from an average of 23.3 percent in 2000 to 20.8 percent in April 2008.

Help-wanted advertising in the St. Cloud Times has slowed in recent months, and a normal seasonal increase in April failed to materialize. In Table 4 we see advertising for workers fell almost 18 percent from last year's levels. Initial claims for unemployment insurance rose 16 percent for the quarter over last year. While employment was up, the number of people seeking employment rose by more, pushing the area unemployment rate to 5.4 percent; there were 491 more individuals seeking employment in April 2008 than April 2007. Smaller increases in unemployment year-over-year happened elsewhere in the state.

The St. Cloud Index of Leading Economic Indicators contains the help wanted and initial claims series, though the impact of the latter series comes with a longer lag. As one can see in Table 5, the effect of help wanted dragged down the index by an amount that we have not observed since this series was introduced in 2003. (Indeed, there has not been a positive number of that magnitude either.) Two of the four components of the index gave positive readings, with a noticeable upswing in the number of hours worked in manufacturing. The impact of the drop in help-wanted advertising, however, moves the index sharply to the negative. The impact of this drop in our newer recession probability index is even more pronounced, with the likelihood of recession in midsummer indicated to be above

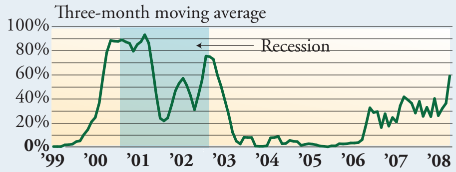
TABLE 4-OTHER ECONOMIC INDICATORS

	2007	2008	Percent change
St. Cloud MSA labor force April (Minnesota Workforce Center)	107,469	109,211	1.6%
St. Cloud MSA civilian employment # April (Minnesota Workforce Center)	102,061	103,312	1.2%
St. Cloud MSA unemployment rate* April (Minnesota Workforce Center)	5.0%	5.4%	NA
Minnesota unemployment rate* April (Minnesota Workforce Center)	4.7%	4.9%	NA
Minneapolis-St. Paul unemployment rate* April (Minnesota Workforce Center)	4.2%	4.5%	NA
St. Cloud-area new unemployment insurance claims Feb.-April average (Minnesota Workforce Center)	937.7	1,089.0	16.1%
St. Cloud Times help-wanted ad linage Feb.-April average, in inches	5,589	4,587	-17.9%
St. Cloud MSA residential building permit valuation In thousands, Feb.-April average (U.S. Department of Commerce)	7,497.7	3,637.7	-51.5%
St. Cloud index of leading economic indicators April (St. Cloud State University)**	101.4	99.2	-2.2%

MSA = St. Cloud Metropolitan Statistical Area, composed of Stearns and Benton counties.
# - The employment numbers here are based on household estimates, not the employer payroll estimate in Table 3.
* - Not seasonally adjusted
**- January-March 2001=100
NA - Not applicable

60 percent. This is the highest reading for a recession probability in the current period of economic slowdown.

PROBABILITY OF A RECESSION



Despite that, we may avoid a recession. The data that led many observers to believe a recession had begun was revised in the past few months and has caused some to wonder if the economy that appeared sure to be in recession in March has somehow changed course and avoided that outcome. Last quarter, we reported on a data revision that changed area employment figures. As the new figures have come out since that point, we see that area employment continues to grow. Numbers were changed as well at the state level. As employment data is largely what is used to forecast state recessions, state forecasts should change with these revisions. As one can see in the graphs nearby, the upward revision of state employment, while not out of the ordinary as revisions go, was enough to make an apparent peak in the Philadelphia Federal Reserve's Minnesota Coincident Indicator Index disappear. Likewise, March state tax collections came in above forecast levels, with only sales tax collections lagging, according to the Minnesota Department of Finance. This would indicate the state economy is growing stronger than expected.

There are obvious factors nationally that should concern us. First, the price of gas has continued to rise, but futures markets in unleaded gas on the NYMEX do not indicate any additional increase in prices in the near term. In an efficient market, the best guess for the price of anything tomorrow is the price you see today; we do not see anything that would change us from that view. As discussion of government policies that would interfere with the normal workings of the market fade (such as tax rebates or windfall profits taxes), greater certainty would probably move prices slightly downward.

TABLE 5-ELEMENTS OF ST. CLOUD INDEX OF LEI

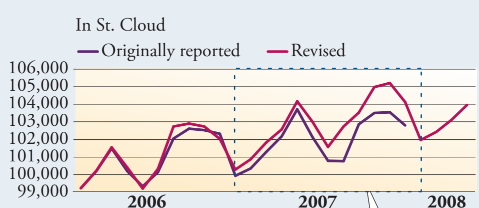
Changes from January to April 2008	Contribution to LEI
Help-wanted advertising in St. Cloud Times	-5.37%
Hours worked	1.54%
New business incorporations	-0.27%
New claims for unemployment insurance	0.67%
Total	-3.43%

*Numbers may not add up to 100 due to rounding.

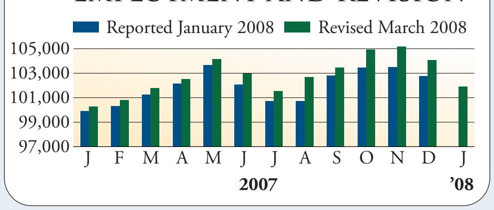
National credit markets remain tight. The April Senior Loan Officer Survey by the Federal Reserve indicated there was higher tightening of loans for commercial, industrial and mortgage lending than in the previous survey in January. The most common feature is a rise in the net interest margin between deposit and lending rates, indicating a credit crunch. Federal Reserve policy is caught between its goals of price stability and high employment. Inflation continues to creep upward, and this will most likely constrain further decreases in the federal funds rate barring more deterioration in the national economy.

Likewise, it is improbable that either fiscal or monetary policy will do much in the near term as the national elections in November approach. We think it is more likely that proposals for controlling gas prices, mortgage lending, or any other regulatory activity will be minimal until after November. The Bush administration has already announced a moratorium on new

ORIGINAL AND REVISED EMPLOYMENT



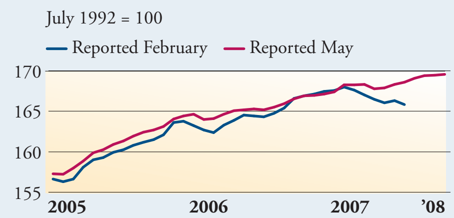
ST. CLOUD EMPLOYMENT AND REVISION



rule-making for the remainder of its term in office. Monetary policy typically holds constant through the election period. Any loosening in credit conditions will come from banks and businesses making private decisions that they can do more business together than from public policy actions.

So what will they decide? On this score, the responses to the St. Cloud Area Business Outlook Survey are troubling. The May reading of the Institute for Supply Management's manufacturing index contradicts the survey, with a reading of 49.6 (a reading of 50 would indicate neither expanding nor contracting production.) New orders were up in the ISM survey. The National Association of Purchasing Managers business barometer also performed above expectations in May.

MINNESOTA COINCIDENT INDICATORS



National business sentiment, in other words, appears to be above sentiments expressed locally. There may be local features in the economy, such as the closure of the DeSoto Bridge, that are giving the local economy a more negative feel. The public investment in its replacement that should come online in midautumn should provide a lift to local construction. And retail-sector employment could get a lift from the stimulus checks distributed to taxpayers.

We cannot emphasize enough how difficult the forecasting environment has been. The energy price increases, uncertain financial regulation from the state and federal level, and uncertainties regarding the presidential election have clouded the horizon for economists and business leaders. While observations above have pointed toward a worsening economy, we think the economy may well have averted a local recession so far due to strong service sector employment outside the retail sector. Even if we can discern later a recession has occurred, the data we see lead us to believe it will be short-lived.

IN THE NEXT QBR Participating businesses can look for the next survey in August and the St. Cloud Area Quarterly Business Report in the October-December edition of ROI. Area businesses that wish to participate in the survey can call the St. Cloud State University Center for Economic Education at 320-308-2157.